

GUIDELINES

for the

RE-USE OF LOCAL REVOLVING LOAN FUNDS (RLF)

COMMUNITY DEVELOPMENT BLOCK GRANT
ECONOMIC DEVELOPMENT PROGRAM
(CDBG-ED)
MINNESOTA INVESTMENT FUND

STATE OF MINNESOTA
DEPARTMENT OF EMPLOYMENT AND ECONOMIC DEVELOPMENT
BUSINESS AND COMMUNITY DEVELOPMENT DIVISION
OFFICE OF BUSINESS FINANCE
March, 2014

INTRODUCTION

The Community Development Block Grant Program (CDBG) administered by the Minnesota Department of Employment and Economic Development (DEED) is funded annually by the U. S. Department of Housing and Urban Development. DEED's Office of Business Finance receives 15% of the states' CDBG annual allocation for the purpose of furthering economic development in the non-entitlement areas of Minnesota. This economic development set aside is operated within the Minnesota Investment Fund (MIF) program, which is supplemented with state funds. *(For purposes of this document, the program will be referred to as "CDBG-ED" and the requirements apply only to the federal funds.)* HUD establishes the CDBG regulations and requirements for the program and has oversight responsibilities for the use of these funds.

CDBG-ED funding is provided to a unit of general purpose local government. *(The local unit of government will be referred to as "the local government")*. In turn, the local government provides a loan to a business to assist with its start up or expansion. DEED allows the community to retain the loan repayments, including principal and interest. Historically, local governments chose to use the repayments to capitalize a Revolving Loan Fund (RLF) for economic development purposes only. It has been found that for many reasons, (i.e., number of years it has taken to accumulate enough cash to actually use the funds, staff turnover, lost paperwork, confusion over the federal requirements, lack of projects, etc.) many RLF's have been inactive. Fortunately, CDBG rules provide flexibility on the reuse of these funds. To assist local governments in the administration of their RLF, CDBG-ED funds can be used for the following:

- 1) Revolving Loan Fund (RLF) for Business Financial Assistance;
- 2) Other CDBG Eligible Activities; and
- 3) Assistance to a Local Development Organization (LDO).

These guidelines will provide general guidance on the requirements for the reuse of the funds. For in-depth information the community must refer to the "CDBG-ED Re-Use Manual," which is available from DEED.

Before determining how these funds will be used, it is strongly recommended a thorough needs assessment of the community be undertaken. Through this process, the community will have a better understanding of its community and economic development needs and will be positioned to effectively address these needs.

SECTION I

Revolving Loan Fund (RLF) for Business Financial Assistance

The establishment of a Revolving Loan Fund within a community is one of several tools available to encourage business development. When establishing a RLF, the local government should begin by determining the economic development needs of their community from which they can develop policies, procedures and guidelines in response to those needs. There is no reason to “reinvent the wheel” as there is a wide array of RLF guidelines, samples of application forms, and legal documents on the web; or DEED’s application(s) may be used. Additional information on the design of a RLF can be found in the “CDBG-ED Re-Use Manual”. Upon completion of the policies and procedures, the grantee must submit them to DEED for approval.

When a RLF is capitalized with repaid CDBG-ED loan repayments, the community takes on a major responsibility, as it will be functioning as a lender. The lending responsibilities are similar to those of commercial lenders and include loan marketing, application processing, credit analysis, lending decisions, loan closing and documentation, and loan servicing, in addition to meeting all of the federal, legal and administrative requirements of the CDBG-ED program.

Because the RLF dollars are public funds, the local government must demonstrate to the taxpayers (as well as DEED and HUD) that their funds are being used wisely and for a public benefit. If a project fails, there may be a loss of public funds and external scrutiny of the local governments lending practices. It is important for the local government to mitigate these risks through prudent screening, underwriting, structuring and monitoring of business loans.

It is strongly recommended that administrators of the RLF take RLF training through organizations such as the National Development Corporation (NDC) or the Council of Development Finance Agencies (CDFA).

Local governments with CDBG-ED RLF’s must keep the following in mind:

The RLF never loses its federal identity. When loans are repaid, all CDBG regulations and requirements that applied during the term of the original project(s) will apply to the RLF. Some of these requirements include, meeting a national objective, public benefit standards, citizen participation, environmental review and Davis-Bacon (prevailing wage). The only exception is when loan repayments are made to a qualified Local Development Organization (See Section III). In addition, the grantee must report to DEED on the use of the RLF on an annual basis as long as the funds continue to revolve.

In compliance with HUD regulations and state rules, the State of Minnesota has chosen to permit the local government receiving CDBG-ED funds to establish a revolving fund to carry out specific, identified activities. A revolving fund, for this purpose, is a separate fund (with a set of accounts that are independent of other program accounts) established to carry out specific activities which, in turn, generate payments to the fund for use in carrying out such activities. These payments to the revolving fund are program income and must be substantially disbursed from the revolving fund before additional grant funds can be requested from the State for revolving fund activities. Such program income is not required to be disbursed for non-revolving fund activities. Interest earned on the revolving fund is program income.

When using the RLF for Business Financial Assistance, the community’s RLF will continue the same activity that the original CDBG-ED assistance was addressed – “financial assistance to a for profit business that will create or retain permanent jobs, of which at least 51% will be taken by or made available to LMI persons.” However, in addition to making a direct loan to a business, there are several other activities that are eligible for funding.

Eligible Activities

The financial assistance to businesses can be provided in the form of *grants, loans, loan guarantees, or other assistance* determined by the community and detailed in their RLF policies. Following are the activities that CDBG-ED RLF's can be used for:

- **Direct Financial Assistance to Businesses**

- Direct financial assistance can be provided to private, for profit businesses that intend to create or retain permanent jobs.
- Funds under this activity can be used to assist a business with the following:
 - Project based land acquisition;
 - Building construction and other improvements;
 - Renovation of an existing building;
 - Purchase of capital equipment;
 - Purchase of an existing building;
 - Site improvements;
 - Working capital;
 - Railroad spurs or similar extensions;
 - Some types of downtown commercial rehabilitation.
 - Retail operations are eligible.
- For example, a low interest loan can be provided to a business to assist with the purchase of equipment as part of a larger project.

- **Infrastructure**

- This includes public works projects necessary for the location, expansion, and/or retention of a specific for-profit business(es). Examples of eligible infrastructure projects are: streets, roads, water, sewer, bridges, sidewalks, parking facilities, drainage systems, railroad spurs, etc.

- **Microenterprise Assistance**

- The RLF may provide direct financial assistance, including loans, grants, etc. and technical assistance to assist with the start up or expansion of microenterprise businesses.
- A microenterprise is defined as a commercial enterprise that has 5 or fewer employees, of which 1 or more is the owner.

- **Business Incubators**

- For the development, rehabilitation or property improvement of a building or the actual construction of a building to house the incubator; and/or
- Provide assistance to businesses locating within the incubator.

- **Job Training**
 - This involves providing skill building classes to employees or potential employees and can be an important part of an economic development program. It can include:
 - Training unskilled, low-income persons for specific jobs for which they have been hired and which require skill levels beyond what they now have through a customized training program;
 - Re-training existing employees of a business as part of a project which qualifies as job retention.
- **Technical Assistance (TA)**
 - CDBG-ED funds can be used to provide TA in either of the following ways:
 - To provide training to the local government to carry out the economic development activities; and
 - To provide technical assistance and training directly to businesses on topics such as business planning or accounting.
- **Administration**
 - Up to \$5,000 of the local governments RLF can be used for administrative costs, however, only to hire a consultant for the application review, processing and servicing of individual projects.

Other Requirements

Economic Development projects funded by the local government with CDBG-ED funds are subject to a wide range of requirements. The local government is responsible to ensure that the operation of the RLF is in compliance with a whole host of federal and state laws, regulations and executive orders. Following are the major requirements. Additional information on these and all other requirements are detailed in the “CDBG-ED RLF Re-Use Manual.”

- **National Objective**
 - All projects must meet one of three national objectives:
 - Benefit to persons of low and moderate income (LMI);
 - To aid in the prevention or elimination of slum and blight;
 - To meet other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community.

In the CDBG-ED category, nearly all projects will meet the Benefit to LMI objective.
- **Public Benefit Standards**
 - These standards ensure that at least a minimum level of public benefit is obtained from the expenditure of CDBG-ED funds. Use of these standards is mandatory.
 - This requirement is separate from the National Objective requirement that 51% of the jobs created or retained be taken by LMI persons.
 - Basically, the standards are a “cost per job” or “cost per goods and services” calculation used to determine if the financial assistance is appropriate.

- **“Anti-pirating” of Jobs**
 - CDBG-ED funds cannot be used for employment relocation activities or “job pirating.”
 - Job pirating refers to the use of federal funds to lure or attract a business and its jobs from one community to another.
 - Specifically, CDBG-ED funds may not be used to assist businesses if:
 - The funding will be used to assist directly in the relocation of a plant, facility or operation; and
 - The relocation is likely to result in a significant loss of jobs in the labor market area from which the relocation occurs.
- **Environmental Review**
 - All projects are subject to the National Environmental Policy Act (NEPA) which seeks to avoid adverse impacts on the environment by mandating careful consideration of the potential impacts on any project assisted with federal funds.
 - All projects must have an appropriate environmental review completed prior to project costs being incurred.
- **Citizen Participation**
 - The local government must include the public in decisions about use of the RLF, as well as each project to be funded.
- **Acquisition/Displacement and Relocation Requirements**
 - Applies to any acquisition of real property when CDBG-ED funds are used for the acquisition.
- **Davis Bacon and Related Acts**
 - Includes the Federal Contract Work Hours and Safety Standards Act, and the Copeland “Anti-Kickback” Act;
 - Applicable when more than \$2,000 of CDBG-ED dollars are used for construction, remodeling, site development and equipment installation.
- **Guidelines and Objectives for Evaluating Project Costs and Financial Requirements.**

These underwriting guidelines are designed to assist the local government to select economic development projects that are financially viable and will result in the most effective use of CDBG-ED funds. The use of these guidelines is **voluntary**; however, local governments electing not to use these guidelines are expected to conduct basic financial underwriting of projects funded under this eligibility category. There are six criteria that must be evaluated:

 - Project costs are reasonable;
 - All sources of project financing are committed;
 - To the extent practicable, CDBG-ED funds are not substituted for non-federal financial support;
 - Project is financially feasible;
 - To the extent practicable, the return of the owner’s equity investment will not be unreasonably high; and
 - To the extent practicable, CDBG-ED funds are disbursed on a pro-rata basis with other finances committed to the project.

Detailed information on these requirements and use of RLF’s can be found in DEED’s “CDBG-ED RLF Re-Use Manual.”

SECTION II

Other CDBG Eligible Activities

The community may broaden the use of the RLF by establishing a program that supports other *community* development needs which combines a wide array of activities. These activities must continue to meet the requirements of the CDBG program. When converting CDBG-ED to CDBG-SCDP, ***the Program Income can only be used as leverage for open active grants or on new applications to SCDP.***

The community must receive approval from DEED's Office of Business Finance if it chooses to use some or all of its CDBG-ED loan repayments for "Other CDBG Eligible Activities." The written request must include the dollar amount to be transferred and a plan for the use of the funds.

The request will be reviewed by DEED's Office of Community Assistance (SCDP staff) and if approved, the community will transfer the agreed upon amount from its RLF to a "Program Income" account. The administration of the Program Income is then transferred to DEED's Office of Community Assistance staff.

- **Federal Objective**
 - All projects must meet one of three national objectives:
 - Benefit to persons of low and moderate income (LMI);
 - To aid in the prevention or elimination of slum and blight;
 - To meet other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community.

Eligible Use of Funds for "Other CDBG Activities": Community Development is the primary focus of these funds. For more information see the SCDP A-Z guide on the DEED website. You can choose one or a combination of the following activities.

- **Housing Activities-rehabilitation of housing which includes Lead Based Paint and historical evaluation and remediation.**
 - Homeowner Rehabilitation – to assist existing homeowners with rehabilitation of their homes.
 - Rental Housing – to rehabilitate rental housing. 51% of the units must be occupied by low to moderate incomes at HUD Fair Market Rents.

- **Commercial Rehabilitation:** Rehabilitation of non-residential building owned privately or by a non-profit. This activity must come in combination with another activity.
 - Code Violations
 - Health and Safety Issues
 - Façade Improvements
 - Energy Efficiency
 - Accessibility Access
- **Public Facilities and Improvements:** Activities that are necessary to improve public facilities for communities that have 51% or greater of low and moderate income persons by census or survey area.
 - Public Improvements include, but is not limited to water and sewer lines, water and wastewater treatment and storage.
 - Public Facilities such as community centers.
- **Assessment Abatement:** The recovery of the capital costs of a public improvement.
 - Abatement assessments are provided to households whose family income is 50% or less of the county median income.
- **Clearance:** Usually related to demolishing structures as a result of a disaster or urgent threat to health and safety in the community.
 - Removal of demolition products (rubble) and other debris.
- **Conversion** – The conversion of a closed building from one use to another.
 - Conversion of a closed school building to residential or for use as an eligible public facility.
- **Program Administration** – for the planning and execution of CDBG activities.
 - Eligible costs include staff and related costs required for overall management, coordination, monitoring, reporting, and evaluation. Application preparation is not an eligible activity with any CDBG funds.
 - This is not a stand- alone or separate budget line item and should be included within the main activity cost.

Note: All Disaster activities will be addressed on a case by case basis.

Other Federal Requirements under the SCDP-Program Income

- **Environmental Review**
 - All projects are subject to the National Environmental Policy Act (NEPA) which seeks to avoid adverse impacts on the environment by mandating careful consideration of the potential impacts on any project assisted with federal funds.
 - All projects must have an appropriate environmental review completed prior to project costs being incurred.
- **Citizen Participation**
 - The local government must include the public in decisions about use of the program income, as well as each activity or project to be funded. A public hearing is required and if funded a second hearing mid-project is required.
- **Davis Bacon and Related Acts-used in commercial rehabilitation, rental rehabilitation of 8 units or more and public facilities.**
 - Includes the Federal Contract Work Hours and Safety Standards Act, and the Copeland “Anti-Kickback” Act;
 - Applicable when more than \$2,000 of CDBG dollars are used.
- **Acquisition/Displacement and Relocation Requirements**
 - Applies to any acquisition of real property when CDBG-ED funds are used for the acquisition.

SECTION III

Local Development Organizations

HUD has recognized the need to lessen the burden to local governments that are administering CDBG-ED funded Revolving Loan Funds (RLF's). Therefore, the Housing and Community Development Act (HCDA) was amended to allow grantees of CDBG-ED funds to sub-grant their award to a qualified non-profit organization to carry out community economic development projects. This process is referred to as "de-federalizing" the funds and by doing so, the RLF is exempt from the CDBG requirements. The local government selects the non-profit organization to carry out the activity and designates it as a Local Development Organization using a LDO agreement.

Because of the large number of underutilized RLF's funded with CDBG-ED funds, as well as the complexity of the CDBG requirements, DEED is strongly recommending that local governments with CDBG-ED RLF's consider the use of this process.

- **Advantages of de-federalization:**

- Decreases the administrative burden on local governments to comply with the onerous CDBG requirements;
- Increased flexibility in the administration of CDBG-ED RLF's;
- Maximizes the flexibility of use of CDBG-ED funds, including accommodating regional approaches to the administration of lending programs.
- No annual reporting to DEED on the use of the funds.

- **Local Development Organization Eligibility Requirements:**

The LDO must meet the requirements of 105(a)(15) of the Housing and Community Development Act. The local government and prospective LDO will be required to complete and submit to DEED a LDO Designation form (attached), indicating that the following requirements related to the eligibility of the LDO have been met:

- The organization is organized as a non-profit under the appropriate Internal Revenue Service code for nonprofits;
- The organization is organized under state or local law to serve the community/economic development needs of communities;
- The organization is independent of the local government;
- The LDO will be "carrying out" the specified activity. In order for loan repayments to become de-federalized, the LDO will be the beneficiary of the loan; and
- The activity shall not be carried out until DEED has approved the LDO designation and Agreement.

- **Process**

DEED awards the CDBG-ED grant to the local unit of government who, after executing the LDO Agreement, grants the funds to the local nonprofit organization that meets the above definition. This entity is now known as the Local Development Organization (LDO). The LDO lends the funds to the business and the loan repayments are returned to the LDO. This loan is subject to the CDBG-ED requirements, however, subsequent loans made by the LDO through the repayments of the original loan are not. The local government monitors the LDO for compliance. DEED monitors the local government. When the project is complete DEED administratively closes the project file. Reporting to DEED on the use of the RLF is not required. Though exempt from the CDBG requirements, the LDO must establish policies and procedures which further economic development in the community.

To accomplish this, the local government must provide the following to DEED:

- Citizen Participation documentation. A public hearing must be held to discuss the transfer of funds to the LDO. Information to be provided to DEED includes: the public hearing notice, public hearing minutes, passage of a resolution concerning the arrangement with the LDO including a stipulation regarding the de-federalization of the funds;
- Draft agreement that is mutually acceptable to both entities,
- IRS documentation establishing the “nonprofit” organization;
- Copy of the LDO’s proposed RLF policies and procedures;
- LDO Designation form;

Upon DEED approval, the agreement may be executed and the RLF policies and procedures finalized.

A local government that has an existing RLF capitalized with CDBG-ED funds can also provide some or all of its RLF to an LDO. The LDO’s initial use of these funds must meet all CDBG requirements and will not be de-federalized until repaid to the LDO. The process for the transfer of funds to the LDO is the same as outlined above.

Once the transaction is completed and the LDO Agreement is executed, the Grantee cannot recall the funds nor can they instruct the LDO on the use of the funds.

Responsibilities for the initial project

- The Local government is responsible for the following:
 - Compliance with all CDBG-ED requirements on the initial use of the CDBG-ED funds;
 - Monitoring the LDO;
 - Obtaining any necessary records from the LDO;
 - Submittal of annual reports to DEED while the grant is open.

- Local Development Organization (LDO):
 - Is responsible for “carrying out” the initial project. This primarily means it will undertake the activity of the project directly or through contracts with an entity other than the local government. In any case, the LDO must have and continue to have a direct and controlling interest in the project and have the capacity for ensuring that program requirements are met. It cannot be simply a passive “pass-through” participant for the local government that performs all of the work.
 - Is responsible for the following minimum activities in “carrying out” the program:
 - Owner of all program policies and processes for the implementation of the program;
 - To manage the program. If the LDO does not have adequate staffing to manage the program it can contract for these services with a private contractor. A solicitation process for the contractor must be conducted in accordance with the open and competitive requirements of the state’s procurement requirements. These services may include but are not limited to performing the daily accounting, application processing, and construction management duties;
 - To be in control of all decisions regarding the transferred CDBG funds, including final loan decisions;
 - Compliance with all federal and state lending requirements;
 - Owner of the resulting loans and loan repayments;
 - To use any repaid funds as specified in the LDO agreement. If, for some reason the LDO dissolves and an asset reversion occurs, contact DEED for assistance. An asset reversion could change the federal identity of any repaid funds; and
 - Final accountability for all CDBG funds received.

No formal procurement process is required for the selection of a LDO. The local government negotiates terms with its selected LDO.

It is recommended that the local government use DEED’s draft LDO Agreement template.

LOCAL DEVELOPMENT ORGANIZATION (LDO) DESIGNATION

Minnesota Department of Employment and Economic Development (DEED)

NON-PROFIT IDENTIFICATION	SUPPORTING DOCUMENTATION
Applicant _____ Contact _____ Address _____ City/State/Zip _____ Telephone # _____ Fax # _____ Federal Tax ID Number _____ Email Address _____	<input type="checkbox"/> Charter <input type="checkbox"/> Articles of Incorporation <input type="checkbox"/> By-Laws IRS Documentation Revolving Loan Fund Policies LDO Agreement Local Government Resolution Public Hearing notice and minutes

NON-PROFIT CERTIFYING OFFICIAL:

I certify that _____ meets the IRS definition of a non-profit organization and is organized (under state or local law) to serve the economic development needs of non-entitlement communities, per Section 105(a)(15) of the Housing and Community Development Act of 1974, as amended, and that the organization will "carry out" the project entitled _____ directly or through contracts with an entity other than the grantee.

To the best of my knowledge and belief, data and information included in this document are true and correct.

Signature

Typed Name and Title

Date approved

LOCAL UNIT OF GOVERNMENT CERTIFYING OFFICIAL:

I certify that the _____ has held a public hearing and passed a resolution naming _____ as a Local Development Organization to "carry out" the project entitled _____.

I authorize the LDO to be the beneficiary of the loan and retain all loan repayments to further economic development in the _____.

I acknowledge that the _____ cannot recall the funds from the LDO.

To the best of my knowledge and belief, data and information included in this document are true and correct.

Signature

Typed Name and Title

Date approved

RESOLUTION OF

(Name of City or County) Requesting Designation of the
(Non-profit Organization) as a
Local Development Organization

WHEREAS, the **(Name of City or County)**, (herein, the **“City” or “County”**) would like to better utilize the Community Development Block Grant Economic Development (CDBG-ED) Set-Aside federal funds; and,

WHEREAS, if the **(“City” or “County”)** retains these funds and their repayment, the funds retain the federal designation and guidelines forever; and,

WHEREAS, the **(“City” of “County”)** by resolution, can request from the Minnesota Department of Employment and Economic Development (DEED), authorization to transfer CDBG-ED Set-Aside funds to a Local Development Organization, herein, (LDO); and

WHEREAS, the **(Name of Non-Profit Organization)** is interested in being designated as an LDO and is a non-profit organization, as defined in Internal Revenue Service regulations, serving the community and economic development needs of a non-entitlement area; and

WHEREAS, the **(Name of Non-Profit Organization)** has adopted procedures and guidelines for the use of the federal funds, the repayment of the federal funds plus any interest accrued, earned or paid thereon.

NOW, THEREFORE BE IT RESOLVED by the **(“City” or “County”)** that the **(“City” or “County”)** hereby requests approval from the DEED to designate the **(Name of Non-Profit Organization)** as a Local Development Organization (LDO), serving the community and economic development needs of the **(“City” or “County”)** and, therefore, authorize them to receive the repayments from the CDBG-ED Set-Aside loan to **(Name of Business)**.

I CERTIFY THAT the above Resolution; was adopted by the **(City Council or Board of Commissioners of the City of _____ or _____ County)** on the _____ day of _____, 20__.

SIGNED:

WITNESSED:

Name/Title

Name/Title